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COMMERCE FOR T.HOFFMAN

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TAGS: PGOV ECON EFIN ENRG EPET ETRD MU
SUBJECT: MORE SPENDING AND RECORD DEFICIT IN OMAN'S 2009 BUDGET

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CLASSIFIED BY: Gary A. Grappo, Ambassador, U.S. Department of State, U.S. Embassy - Muscat; REASON: 1.4(B), (D)

SUMMARY

¶1. (C) Despite a slowing economy, Oman's 2009 budget forecasts increased government revenues and spending. It also features a record high deficit of over USD 2 billion that could increase if the projected annual average sales prices for Omani crude oil fails to reach the USD 45/barrel target. Current low oil prices are a major factor in projections for real GDP growth of only one percent (compared to 10 percent in 2008) and have already prompted Oman's second largest oil producer, U.S.-based Occidental Petroleum, to reduce American staff to cut costs. Lower government oil revenues may also aggravate the negative affects of the global credit crunch, which has denied dollars from international institutions to local banks for capital project lending. End Summary.

BUDGET ROLLOUT

¶2. (U) Oman's Minister of National Economy and Deputy Chairman of the Financial Affairs and Energy Resources Council, Ahmed bin Abdulnabi Macki, announced Oman's state budget for 2009 at a press conference January 3. The new budget forecasts the year's total revenues at 5.614 billion Omani Rials (RO) (approximately USD 14.6 billion), up by RO 214 million or four percent from the 2008 figure. Expenditures are estimated to reach RO 6.424 billion (USD 16.7 billion), an increase of RO 624 million from the previous year. The resulting anticipated deficit of RO 810 million (USD 2.106 billion) is the largest projected deficit in Omani history and correlates to 5% of GDP and 14% of total revenues.

¶3. (U) Macki told local media that although the deficit was "high" in absolute value, it was nevertheless "economically reasonable" as a percentage of GDP. He added that despite the projected budget shortfall, the government was "committed to proceeding with the execution of ongoing projects" and would cover any deficit spending from the State General Reserve Fund.

STILL DEPENDENT ON HYDROCARBONS

¶4. (U) Revenues from oil and gas production will continue to provide the lion's share of the government's income. According to the budget, oil sales will contribute roughly RO 3.52 billion, or around 67%, of total revenue, while gas sales will generate RO 620 million or approximately 12%. Macki stated that oil revenue was estimated on the basis of an average annual price of USD 45 per barrel with an average daily production of 805,000 barrels, compared to 750,000 barrels in 2008. The Minister said that he expected oil prices to "stabilize by the middle of the year" in the USD 60-65 per barrel range. If oil prices continued to remain low or fell even further than current levels, the government would be forced to reassess and reprioritize development projects, Macki added. Public sector salaries, he assured, would not be touched.

SPEND, SPEND, SPEND

¶5. (U) With respect to budget outlays, oil and gas production costs account for 21% of expenditures while education and health care represent 36% and 12%, respectively. The remaining 31% is distributed over a variety of other sectors. Defense and security spending is expected to increase by 14%, totaling approximately OR 1.545 billion (USD 4.02 billion). The government's budget for participation in "domestic, regional and international institutions," which includes financing projects undertaken by government-owned companies such as Oman Oil Company and OMRAM (the state tourism development firm), will rise by a hefty 43%. Allocations for other ongoing and new infrastructure and development projects are estimated at RO 800 million, representing a 10% increase over the previous year.

¶6. (U) While claiming that Oman had remained above the global economic crisis in 2008, Macki acknowledged that the Sultanate's economy would be adversely affected by the worldwide economic slowdown and lower oil prices in the coming year. Real GDP growth in 2009 was consequently expected to drop to 1% from an impressive 10% in 2008, he commented. On a more positive note, Macki predicted that the inflation rate would fall below 10% in 2009 from a level of 12.4% between January-October 2008, thanks in large part to a drop in global commodity prices.

OIL PRICE WOES

¶7. (C) In formulating its budget, Oman has traditionally underestimated the price of its crude oil to allow plenty of padding in the face of an unpredictable oil market. The 2008 budget, for example, projected a deficit of RO 400 million (USD 1.04 billion) based on an average per barrel price of $45 for Omani crude, but the Sultanate instead recorded a healthy surplus for the year due to record high price levels. This year, however, promises to be a different story as depressed global oil prices show no signs of a strong recovery.

¶8. (C) Given the relatively high production costs for extracting and producing Omani crude, current low prices are tightly squeezing oil sale profit margins. In December 2008, the Under Secretary of Oman's Oil and Gas Ministry commented publicly that falling oil prices might be insufficient to even cover production costs, a concern echoed by some energy industry contacts. U.S.-based Occidental Petroleum, the second biggest oil producer in Oman, recently terminated a number of expatriate employment contracts and

ordered the return of approximately 28 American employees and their families to the U.S. in an effort to cut costs. Moreover, without a rise in oil prices, new drilling operations in Oman may be put on hold, meaning that the projected increase in oil production will have to be met by boosting output in existing fields through enhanced oil recovery techniques.

PLENTY OF RIALS, BUT FEW DOLLARS

¶9. (C) Uncertainty over government oil revenues will only aggravate the restraints on development project financing already imposed by the global credit crunch. While local banks have more than sufficient local currency on hand, financial sector contacts assert that Omani banks are not able to obtain dollars from international institutions for lending beyond 90 days. Such a short time period effectively precludes capital project lending and restricts borrowing to finance trade only. To aid local banks, the Central Bank of Oman has attempted to inject dollars into the financial system and recently cut reserve requirements from eight to five percent and loosened the required loan-to-deposit ratio to 87.5% from 85%.

WEATHERING THE STORM

¶10. (C) Despite the all the economic gray clouds, Oman may be able to emerge from 2009 with positive real GDP growth barring a further collapse in world oil prices. The recently implemented U.S.-Oman Free Trade Agreement (FTA) should provide increased trade opportunities for Omani businesses while improvements in the Sultanate's overall investment climate (driven in part by the FTA) may help retain and attract outside capital. Perhaps more importantly, generous government spending as reflected in the 2009 budget should provide a major stimulus to the slowing economy even with the inevitable postponement or scaling back of some development projects. As Macki noted in his press conference, there is no question that the government can cover deficit spending by using the State General Reserve Fund. The better query is why Oman would want to cash in equities in its primary sovereign wealth fund that undoubtedly suffered steep paper losses rather than use its excellent credit rating to borrow on international markets so as to allow the prices of its foreign shares to recover.
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